



AGL Petronas Consortium

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Submission on the Proposal for Consultation: Review of the National Gas Pipelines Access Regime and the Regulatory Impact Statement on Greenfield Incentives

The AGL Petronas Consortium welcomes the opportunity to comment on the Proposal for Consultation on the Review of the National Gas Pipeline Access Regime.

In the attached Submission, APC has concentrated its comments on the proposed incentives for enhancing certainty for Greenfield projects. Of particular concern to APC is the possible impact of those incentives on the proposed PNG Gas Pipeline.

Although the complexity of the commercial and regulatory requirements will increase with the size and complexity of the proposed development, the issues facing the PNG Gas Pipeline would be similar to those faced by all other future greenfield pipelines. The PNG Gas Pipeline is therefore a real case study of the practical value of the proposed greenfield incentives.

The prospective users of proposed greenfield pipelines require timely and secure flows of energy, to facilitate this the regulatory approval process must be both certain and timely. APC submit that the adoption of Option 4 of the Greenfields Incentives Regulatory Impact Statement achieves this aim.

If you have any queries please contact David Pringle on (02) 9921 2405.

Yours Sincerely,

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Project Manager Regulation
PNG-Qld Pipeline Project

APC Submission to the MCE on the Proposal for Consultation: Review of the National Gas Pipelines Access Regime and the Regulatory Impact Statement on Greenfield Incentives

The PNG Gas Pipeline Project

The AGL Petronas Consortium (APC) successfully won a tender run by the PNG gas producers in 1998 to build a natural gas pipeline from the border of the PNG and Australian territorial waters to markets in Australia. Access Principles were developed from the 1998 tender that was conducted under the auspices of the Queensland Department of Mines and Energy and the ACCC. These access principles provided APC with 20 years of regulatory certainty.

The development of the market for PNG gas has taken considerable time and the Queensland Government has advised that the Access Principles developed from the 1998 tender lapsed in 2003.

In July 2005, the upstream owners of the PNG resources advised the market that there were sufficient conditional gas supply agreements to proceed to project sanction. Project sanction is scheduled for mid 2006. First gas deliveries are required by 2009 to satisfy demand in Townsville and Gladstone and to supply customers throughout eastern Australia.

The proposed pipeline route links across to Gove and extends down the Queensland coast to Gladstone and across to central Australia where it will link with the Moomba-Adelaide pipeline and the Moomba-Sydney pipeline. It will be more than 3,800 km in length and cost around \$3 billion. It will result in a substantial interconnected gas transmission grid across eastern Australia increasing the security of supply for Queensland, South Australia, ACT, NSW and Victoria and provide competitively priced, high volume natural gas to eastern Australia.

For the pipeline to be developed, APC requires reasonable assurance over the regulatory outcome by project sanction targeted for May 2006 and absolute certainty by financial close targeted for September. Proceeding beyond financial close will involve the commitment of around \$5 billion, including the upstream component. For investors to commit to this expenditure, they must have certainty the project would have the opportunity to earn a return commensurate with the risk involved.

Due to the size, complexity and risk, the financiers of the PNG Gas Pipeline will not proceed beyond financial close without a resolution to the regulatory uncertainty in relation to proposed pipeline tariffs.

Time Constraints

APC is currently carrying out the Front End Engineering and Design (FEED) Process at a cost of almost \$70m. FEED is targeted for completion in April 2006 to provide high quality information for project sanction. It is not until this date that sufficient information (finalised route, pipeline size & compression, forecast load and projected capital and operating costs) will be known for the preparation of either an access arrangement or an application for revocation of coverage. Actual capital cost will not be known until 2009.

Project sanction, at which point both the APC Pipeline Developers and the upstream PNG Gas Producers will commit in principle to an estimated \$5 billion of capital expenditure is planned for May 2006. Following project sanction, final due diligence and financing arrangements will be completed incurring material additional

expenditure. Final commitment by all parties to incur the full expenditure will occur at financial close targeted for September 2006.

Details of the complexity of the project are set out in Appendix 1. The essence however is that there is a very short window of opportunity between the time when sufficient detail will be known to prepare an application for coverage and/or an access arrangement and the time for final commitment to invest a forecast \$5 billion.

There is no possibility that either a decision on the present coverage criteria (even assuming that the Code allowed for binding non-coverage rulings) or the approval of an access arrangement could be finalised in this time.

If financial close is materially delayed, then the delivery date committed to foundation customers can not be met. Customers critical to the success of the pipeline will then pursue their own commercial interests and seek other sources of energy.

Greenfield Incentives Proposed in the Consultation

There are two measures proposed in the Proposal for Consultation to enhance regulatory certainty for greenfield projects. APC supports the introduction of both measures.

Measure 1, a Binding No Coverage Ruling would help avoid unnecessary regulation in some circumstances, but with its experience from developing the PNG Gas Pipeline, APC doubts that this measure alone would be of any practical benefit to most new pipeline developments.

The time taken to obtain a coverage ruling means that this measure (by itself) would be no practical benefit to the PNG Gas Pipeline, or any future pipeline of similar size and complexity.

The implementation of measure 2, a Price Regulation Holiday would give the PNG Gas Pipeline a regulatory outcome similar to that resulting from the lapsed 1998 tender. The major variation from that outcome is that prices would be free from regulatory intervention for 15 years as opposed to the 20 resulting from the tender. APC strongly supports the introduction of this measure.

Of the options discussed in the Greenfield Incentives Regulatory Impact Statement, Option 4, the combination of Measures 1 and 2 from the Proposal for Consultation would be of greatest assistance to the developers of new greenfield pipelines. Measure 1 would give a pipeline the capability to operate in a competitive manner, provided it is able to pass the coverage test. This measure however is unlikely to be of practical use to many greenfield pipelines due to the critical short time period between project definition and financial close. Measure 2 would give a pipeline regulatory certainty over prices (which is critically important) without the full ability to act competitively. Neither of these measures by themselves provides a greenfield pipeline developer the "complete package"

APC therefore urges the MCE to proceed with Option 4 from the Regulatory Impact Statement, which is to give a pipeline developer the right to seek a price regulation holiday and then to subsequently seek non-coverage.

Implementation of the Proposed Measures

The adoption of Option 4 of the Greenfield Incentive Regulatory Impact Statement by the MCE would be of great assistance to the developers of greenfield pipelines, including the PNG Gas Pipeline. However for the proposed measures to be effective three additional practical matters need to be addressed.

Firstly the details of the criteria for qualification for a price regulation holiday must be clear and concise so that a decision on qualification for a price regulation holiday can be made in a timely fashion (say 28 days).

Secondly the process for processing an application for a price regulation holiday must be clear and straightforward.

In appendix 2, APC provides some suggestions for consideration in developing the details of the greenfield criteria and the process of obtaining a ruling on the greenfield criteria.

Thirdly, if constructed, the PNG Gas Pipeline will be the most significant gas transmission pipeline to be built in Australia both in terms of size and its impact on competition in the Australian gas market. It would be ironic then if measures proposed to assist investment in greenfield gas transmission pipelines were implemented too late to be of any assistance to the PNG Gas Pipeline.

Therefore APC urges the MCE not only to introduce the proposed greenfield incentives but also to expedite their introduction to give prospective financiers of the PNG Gas Pipeline reasonable assurance of the regulatory status of the pipeline by project sanction in May 2006 and absolute certainty by financial close in September.

Appendix 1: Complexities and Time Constraints on the PNG Gas Pipeline

Front End Engineering & Design (FEED)

The PNG Gas Pipeline is an integral part of the total PNG Gas Project that also involves upstream development in PNG. At financial close various parties will commit to a forecast \$5 billion of capital expenditure. A number of entities will be required to commit to this expenditure including the APC partners (AGL and Petronas), the five partners in the upstream development and the financiers of both developments.

The FEED for both the pipeline and the upstream development is underway. Bringing together the FEED process is itself a complicated exercise. The complexity of the process can be readily indicated by the FEED costs - APC is spending around \$70m, and the upstream participants around an additional \$100m.

Issues that will be resolved in this phase of the pipeline project are:

- Where is the gas and where are the customers?
- What is the most efficient route for the pipeline - taking account of constructability, environmental and land access issues?
- What existing infrastructure can be used to deliver gas to customers?
- How large to construct various segments of the pipeline?
- Can all requisite licensing, environmental, native title, land tenure and technical approvals be obtained?
- How much compression is to be used and when and where will the compressors be installed?
- How will capacity be expanded over time?
- What is the estimated capital and operating cost?

Prolonged uncertainty over the project will inevitably lead to repeated re-engineering. Each variation in projected market generates new scenarios for each of the above variables.

An example of the inter-relationships of the project is the consequences of a change in projected load leading to, for example, a change in the route or the size of the pipeline. This has flow on effects as to:

- Where and when the linepipe can be acquired and at what cost?
- How the linepipe is transported and at what cost? - the larger the pipeline the more it weighs and the harder it is to transport
- How quickly it can be welded? - the larger the pipe the slower the welding rate
- How quickly construction teams can move and accordingly the rate and cost of construction?
- A change in engineering design or route means construction plans will need to be readdressed and re-costed
- Licensing approvals and land access need to be re-addressed.

It is expected the FEED process will be completed at the end of March or in early April 2006. It is not until that stage that the key issues such as those listed above will be known with confidence. As a consequence it would not be possible to prepare any application for coverage or a proposed access arrangement until April 2006.

Time Imperative of Foundation Customers

Foundation customers of the PNG Gas Pipeline will commit to take large quantities of gas for a period of twenty years from date of "first gas" in 2009. It is expected that foundation contracts will represent a significant proportion of total pipeline throughput and without adequate foundation load the pipeline will not proceed.

Foundation customers however require that gas supplies will commence from the target date. A delay in financial close (such as that necessary to seek a coverage decision) would delay the date of first gas deliveries and customers critical to the success of the pipeline would then pursue their own commercial interests and seek other sources of energy.

Construction Complexity

Although the pipeline parameters are yet to be determined, the pipeline is expected to extend over 3,800 km from PNG to central Australia, with laterals to Gladstone and the Northern Territory. Much of the pipeline will be constructed in the far north of Australia where the weather patterns are such that it is only possible to construct during "weather windows" provided by the dry seasons. A six-month delay in the commencement of construction could well result in a twelve-month delay in the completion of construction, due to the intervention of the wet and cyclone seasons.

Apart from the weather, a construction project of this size is a complicated logistical exercise. APC will be procuring over half a million tons of steel, which then needs to be protectively coated and shipped to Australia (for imported steel) or otherwise coated and transported domestically. Detailed procurement contracts from multiple vendors will be required. Procurement contracts will reflect market prices for steel and foreign exchange rates will need to be appropriately hedged.

Mill production schedules will be integrated with the expected construction schedules. Shipping transport bookings will be integrated with the mill production schedules and the required delivery dates to the construction site itself. Insurance arrangements will reflect the above.

Moving pipeline from the receiving port to construction right of way is a major exercise in itself. APC needs to move over half a million tonnes of steel across inhospitable territory. In some cases APC will need to build roads and bridges and augment port and rail infrastructure in order to deliver the pipeline to site. All of this civil engineering work will be planned and costed around the expected engineering and construction program and weather windows.

No such project has a spare 6 months or so to wait for regulatory clarity - anything like this amount of time will place the project under severe stress. Any greenfields regulatory incentive must be capable of giving certainty within around a single calendar month. Prolonged delay immediately puts pressure on commercial contracts, construction schedules, procurement and logistical planning, all of which are interrelated.

Project Sanction and Financial Close

In order to meet the target date for first gas in 2009, APC and the PNG upstream partners are targeting project sanction in May 2006 followed by financial close in September.

At project sanction both the APC Pipeline developers and the upstream PNG Gas Producers will commit in principle to an estimated \$5 billion of capital expenditure. Following project sanction, due diligence will be carried out with a final commitment by all parties to incur the expenditure at financial close.

One of the prerequisites for the project to proceed beyond project sanction and financial close is the requirement for certainty as to the ability of the pipeline to set market based tariffs, in the spirit of the outcome of the 1998 competitive tender.

Appendix 2: Considerations in developing the details of the greenfield criteria and the process of obtaining a ruling on the greenfield criteria

Use of the Term "Market"

The term "market" should be avoided in developing the greenfield criteria. Competition law connotations accompany the term "market", which suggest that a detailed and time-consuming evaluation would be necessary if "market" were used as part of the greenfields criteria. (eg When coverage of the EGP was being considered there was lengthy debate over whether the whole of south eastern Australia constituted a market or could it be broken into smaller sections).

An alternative approach may be to use a term such as "significant load-centre", and then define the term, having regard to the objectives of the price regulation holiday proposal. For example, a "significant load-centre" could comprise either connection to a distribution system or another site where there is significant consumption of natural gas.

It is understood that the proposal concerns significant load centres directly connected to the relevant pipeline. APC understands that should the PNG Gas Pipeline connect to Moomba, then Moomba would not be defined as a significant load-centre, just a transportation hub for significant load centres such as Sydney (or the area covered by AGL NSW Distribution system) and Adelaide (or the area covered by the Envestra SA Distribution system). The definition of a "load centre" would need to address this issue.

Failure of Relevant Minister to decide an application within 28 days

The Proposal currently provides for the Relevant Minister to reach a decision on declaration within 28 days of the making of an application. There is no discussion of what would occur if the Relevant Minister did not make a decision either way for whatever reason. In order to provide commercial certainty concerning the timeframes, APC submit that the proposal should include a provision that a failure to decide is a deemed declaration.

Consequences of Subsequent Changes in Circumstance

For the greenfields investment regime to be certain, the assessment as to whether the pipeline is granted a regulatory holiday should be made in response to an application by the pipeline owner on the circumstances at the time of the application. The regulatory status of the pipeline should not be lost as a result of a subsequent changed circumstance such as a change in market forecasts or pipeline ownership.

For example, if a merger of pipeline operators were potentially to remove the independence of one pipeline from another, that issue would be fully addressed through section 50 of the *Trade Practices Act*.

Independence

APC is not convinced that there is a sound policy reason for the inclusion of the independence aspect of the proposed greenfield criteria. APC submit common ownership should not be a problem so long as there is proper ring fencing, similar to the existing ringfencing requirements between a Service Provider and Related Businesses.

If a notion of independence is to be included however, it is important that the greenfields criteria are capable of objective and timely assessment but are not so rigid as to prevent particular corporate structures. APC submit if there is to be a

requirement for independence included in the greenfield criteria, then the most appropriate balance would be to provide that:

- *the Minister must be satisfied that the capacity on the two relevant pipelines is marketed independently and that confidential information is only used for the purposes intended; and*
- *where the parties marketing capacity are not Related Bodies Corporate (as that term is defined in section 50 of the Corporations Act), the parties shall conclusively be taken to be independent of each other for the purposes of the criterion.*

Evidence

It is important in determining the applicability of the proposed criterion "c" (or any similar criterion) that it is clear what evidence or material is sufficient to satisfy the criterion. For instance, with respect to whether or not the proposed 30% threshold is satisfied the Service Provider may not be in a position to conclusively establish whether its customers are in fact using the capacity they purchase for on-haulage. It should be sufficient for the Service Provider to demonstrate that the estimates are the Service Provider's reasonable estimates using the information available to the Service Provider.